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Collins Forensic and Valuation Services

3600 American River Drive, Suite 147, Sacramento, CA 95864 Phone 916.756.5622

10 Most Common Business Valuation Errors

1. **FAILING TO INTERVIEW MANAGEMENT AND VISITING THE BUSINESS'S OPERATIONS.** Interviewing management and touring a company's business location provides crucial insight into the key factors affecting the company's operations, such as, capacity constraints, competency of management and employees and current business activity.

2. **RELYING ON ONE BUSINESS VALUATION APPROACH OR METHOD.** The Cost, Income and Market approaches should all be considered in valuing a business. Considering multiple valuation approaches allows business appraisers to more adequately support their valuation conclusion.

3. **NOT LOOKING FOR RECENT SALES OF SIMILAR BUSINESSES.** Thoroughly searching for recent sales of similar or "guideline" businesses is crucial in applying the market approach. The multiples at which guideline businesses have recently sold is the best indication of what a business would sell for in the open market. Generally, there is little relationship between the valuation multiples of large publicly traded companies and closely held businesses.

4. **FAILING TO ACCURATELY DETERMINE MANAGEMENT'S REASONABLE COMPENSATION.** Any assumptions regarding management's compensation should be supported by compensation studies and should consider management's skills, responsibilities, hours worked and years of experience.

5. **NOT CONSIDERING TRENDS IN A COMPANY'S EARNINGS.** Trends over time in a company's income statement and balance sheet items, such as sales, earnings, assets, debts, etc., can indicate whether a business is growing stronger or getting weaker and can have a dramatic affect on a company's value.

6. **INABILITY TO CLEARLY EXPLAIN HOW A COMPANY'S CASH FLOW WAS DETERMINED.** A business appraiser should be able to clearly support how the company's valuation cash flow was computed and what adjustments were made for depreciation, management compensation and perquisites, etc.

7. **FAILING TO DEFINE THE STANDARD OF VALUE USED IN THE VALUATION REPORT.** Fair Market Value is the most common standard of value. Make sure the appraiser has defined and consistently applied this standard of value in valuing the company.

8. **MAKING AN ILLOGICAL CONCLUSION.** The business's cash flow should support the concluded value or purchase price. Depending on the industry, it is often assumed a buyer of a business will put down 30% in cash and finance the remaining balance due over 5 to 10 years. After making this assumption, determine if the business's cash flow can service the note.

9. **NOT SUPPORTING DISCOUNTS AND PREMIUMS.** The percentages applied should be supported by a well thought out analysis of the factors that affect premiums and discounts.

10. **FAILING TO ACCURATELY VALUE A BUSINESS'S REAL ESTATE.** The stated value of real estate on a company's books maybe below the current fair market value of the property. This is especially true in businesses where the real estate was purchased a long time ago.

QUESTIONS OR COMMENTS

Please call me with your comments at 916.756.5622

— Thomas Collins, CPA / ABV, CFA

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